United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-7108

To Be Argued By:

Martin Kleinbard

United States Court of Appeals

For the Second Circuit

PIERRE J. LELANDAIS & CO., INC., PIERRE J. LELANDAIS, RESEARCH & SCIENCE INVESTORS, INC., INTERCONTINENTAL TECHNOLOGY & NATIONAL RESOURCES, CORONET FUND and CREATIVE CAPITAL FUND,

Plaintiffs-Appellees;
Cross-Appellants,

vs.

MDS-ATRON, INC. and MOHAWK DATA SCIENCES CORP.,

Defendants-Appellants;
Cross-Appellees,

and

JOSEPH S. STOUTENBURGH and RICHARD L. KARPEN,

Defendants.

On Appeal from the United States District Court

For the Southern District of New York

REPLY BRIEF OF DEFENDANTS-APPELLANTS AND BRIEF IN OPPOSITION TO THE CROSS-APPEALS

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With respect to the issues on appeal, plaintiffs now clearly argue that they are under no duty to prove that the proxy statement "omissions" of which they complain <u>would</u> have been important to any Atron shareholder, and, further,

that defendants were properly precluded from proving that the alleged omissions were in fact immaterial to the specific plaintiffs involved in this non-class, non-derivative action. Further, plaintiffs argue that the manifest mechanical and theoretical errors committed by the Court below in measuring damages should be disregarded and, indeed, that the damage award should be augmented.

On their cross appeal, plaintiffs challenge the dismissal of their claim that the proxy statement was materially defective for failure to state, expressly, that in exchange for their restricted Atron stock, these plaintiffs would receive similarly restricted Mohawk stock; plaintiffs do not challenge the findings below that there were no affirmative representations, oral or written, by any defendant that the Mohawk stock so exchanged would be "free." Plaintiffs do not directly challenge the District Court's clear conclusion that these plaintiffs knew or should have known that new unrestricted Mohawk stock could not be delivered to them without a new registration under the 1933 Act.

Finally, plaintiff ITNR cross-appeals from the judgment dismissing all of its claims on the ground that the record shows that this particular plaintiff was not in fact damaged by any data contained or omitted from the proxy materials.

POINT I

DEFENDANTS-APPELLANTS SHOULD PREVAIL WITH RESPECT TO ALL ISSUES RAISED ON THEIR APPEAL (REPLYING TO POINTS I, II AND III OF PLAINTIFFS' BRIEF)

Defendants' appeal is based upon three significant errors committed by the District Court, relating to (1) damages, (2) materiality and (3) reliance.

Not surprisingly, plaintiffs dispute all of defendants' points. Their brief makes clear that, in their view, they can recover in this non-class action if defendants negligently omitted from the proxy statement any single fact which *might* arguably have been of some importance to some hypothetical stockholder -- even though the omitted matter was of no importance whatsoever to any of these particular plaintiffs, and even though no trier of fact could reasonably conclude that the omitted data *would* have mattered to any stockholder. Further, plaintiffs believe that once they have met this miniscule burden of proof, the "flawed" proxy statement becomes, in effect, an insurance policy, guaranteeing them against all losses resulting from their speculative retention of the stock in question.

We are confident that the law is not what plaintiffs would like it to be.

A. The Measure of Damages

The standard by which the District Court purported to measure damages was correct: If plaintiffs were injured at all,

their damages are measured by the value of what they gave up (their statutory right to an appraisal of their Atron stock), less the true value of what they received (one share of Mohawk for every four shares of Atron).

Although all parties concede this is the customary out-of-pocket standard, plaintiffs imply that this formulation is some novel invention of defendants. (See Pl. Br. 16.)* The implication is baseless. The formula, adopted by the District Court, is nothing less than what the law commands. See plaintiffs' own prime authority, Swanson v. American Consumer Indus., Inc., 475 F.2d 516, 521 (7th Cir. 1973).

The District Court's error lies not in its choice of standards, but rather in its application of the appropriate test. Plaintiffs received Mohawk stock substantially more valuable than what they gave up. Plaintiffs were simply not damaged, whether or not there were some arguable omissions from the proxy statement. Thus, plaintiffs failed to prove a critical element of their claim: that they suffered any out-of-pocket loss as a result of defendants' conduct. Abrahamson v. Fleschner, CCH Fed. Sec. L. Rep. ¶ 95,028 (S.D.N.Y. 1975) (10b-5 case).

While indicating their willingness to accept whatever damages they can get, plaintiffs persevere in their effort to calculate damages on the basis of a benefit-of-the-bargain

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* References to "Pl. Br. __" are to the pages of plaintiffs' answering brief on this appeal.

theory. Plaintiffs studiously avoid describing their theory in such terms, apparently recognizing the inappropriateness of such an approach in this case.

1. The Value of Plaintiffs' Appraisal Rights

(a) The Court's Calculation

In the absence of directly controlling Minnesota case law, the District Court consulted New York law and reached the generally accepted conclusion that, in an appraisal situation, "fair cash value" is quantified by giving weighted consideration to the net asset value, investment (or earnings) value and market value of the stock being evaluated.

However, the District Court then proceeded to ignore its self-acknowledged standard, giving no weight at all to Atron's readily determinable net asset and investment values (less than $4.00 per share), its painfully obvious earnings value ($0.00) or its easily inferable market value (substantially less than $6.88 per share).* Instead, the Court held that defendants were estopped from denying that the Atron stock was worth $8.60 per share on April 30, 1971, the date of the merger, because on March 12, 1971 -- the date as of which Mohawk had agreed to the merger -- Mohawk stock sold for $34.40 (4 x $8.60). Instead of evaluating, the District Court estopped -- a unilateral invocation of an unrequested, unsuggested and inappropriate doctrine.

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* $6.88 was the average bid price for Atron stock in the period from January 4 through January 29, 1971. See defendants' main brief at p. 32.

(b) Plaintiffs' Theory

Plaintiffs are, perhaps understandably, not content with the results of this arbitrary "March 12" estoppel by the District Court. They persist in arguing that the fair market value of Atron is fixed by the market price of Mohawk on the day of the merger, April 30.

Pursuant to their unstated but pervasive benefit-of-the-bargain approach, plaintiffs would have this Court believe that because Mohawk stock sold for $44.62 per share on April 30,

> "it was represented to plaintiffs, and all other Atron shareholders, that they had $11.15 in Mohawk stock 'coming to them' for every share of Atron stock." (Pl. Br. 9,10)

But plaintiffs were never offered cash in exchange for their Atron stock. They were offered Mohawk stock. No representation was ever made by any defendant that the Mohawk stock so offered would ever be worth any specific amount.

Moreover, even if Mohawk had offered $11.15 in cash for each Atron share -- which it never did -- it would not follow that an Atron share had a "fair cash value" as great as that. For many possible reasons, one company may offer to acquire another (for stock or even for cash) at a premium over its fair cash value or market value. See, e.g., Gibbons v. Schenley Indus., Inc., ________ Del. ________, A.2d ______, (Del. Ch. 1975) (Slip Opinion at 11). Indeed, such was the case here. (See defendants' main brief at pp. 24-25, 30.)

If plaintiffs were correct in their notion that the statutory appraisal value of the stock of a company being acquired is, at a minimum, equal to the market value of the stock of the acquiring company offered in exchange, then shareholders of an acquired company would always assert their appraisal rights, secure in the knowledge that they could not lose by doing so. In short, as a legal or as a business proposition, plaintiffs' argument is absurd.

(c) Plaintiffs' Principal "Authority"

Plaintiffs' contention that the fair cash value of Atron should be fixed by the market value of Mohawk on the date of the merger is based upon a misreading of a recent Seventh Circuit case, *Swanson v. American Consumer Indus., Inc.*, 475 F.2d 516 (7th Cir. 1973), *supra*. According to plaintiffs,

> "the [*Swanson*] court held that plaintiffs were entitled to damages reflecting the appraisal value of their stock in the company being acquired, which it determined solely by reference to the value attributed to that stock in the reorganization plan. In the instant case, the value attributed to the Atron stock in the merger was one-fourth of $44.62 (the price of Mohawk) ...." (Pl. Br. 14-15)

Swanson, of course, is not controlling in this Circuit. Nor is it a case arising under § 14(a) of the Act, but rather a 10(b) case, involving fraud. Moreover, had the Court below correctly followed *Swanson*, no damages whatsoever would have been awarded to plaintiffs here. Since it is the lynch-pin of plaintiffs' theory, the facts of *Swanson* deserve detailed review.

Plaintiff Swanson represented a class of former stockholders of Peoria Service Company ("Peoria"), an Illinois corporation engaged in the warehousing business. Eighty-six percent of Peoria's 81,594 outstanding shares were held by American Consumer Industries, Inc. ("ACI") through a subsidiary. On March 11, 1965, Peoria and ACI entered into an agreement providing for the acquisition of Peoria's assets by ACI in exchange for about 16,300 shares of ACI stock, i.e., one share of ACI for every five shares of Peoria outstanding. The intention was to distribute the ACI stock to Peoria shareholders as a liquidation dividend. This plan was approved by Peoria's shareholders on March 31, 1965.

Swanson commenced his litigation on March 29, even before the merger was complete -- unlike plaintiffs here, who waited a speculative year before complaining. Summary judgment was initially granted to defendants, 288 F. Supp. 60 (S.D. Ill. 1968), but was reversed and remanded on appeal, 415 F.2d 1326 (7th Cir. 1969). After trial, the District Court once more rendered judgment for defendants. 328 F. Supp. 797 (S.D. Ill. 1971). On a second appeal, the Seventh Circuit again reversed, but with instructions obviating the need for a retrial. The Court of Appeals held that ACI was guilty of securities fraud and that plaintiffs were entitled to damages, stating,

> "In such a posture the appropriate remedy is to restore to the plaintiff shareholders the opportunity to receive cash rather than ACI shares. Therefore, ACI must offer to each Peoria shareholder $3.55, the market value attributed to Peoria stock in the

> reorganization plan, for each share of Peoria stock held by such shareholder on March 31, 1965 . . . ." (475 F.2d at 521)

Contrary to plaintiffs' reading of the opinion, the Swanson record makes clear that the $3.55 figure adopted by the Seventh Circuit was not one-fifth of the market value of ACI stock on the day of the ACI/Peoria merger, March 31, 1965. Rather, $3.55 was the per share net asset liquidation value of Peoria. This is clear from the findings of the Swanson trial court:

> "No formal appraisal of Peoria's assets was obtained prior to the adoption of the plan of reorganization or prior to the special meeting of shareholders on March 31, 1965. Robinson [the president of both Peoria and ACI] and other executive officers had had substantial experience in the buying and selling of cold storage facilities and they were intimately familiar with Peoria properties.
>
> The total exchange evaluation of about $285,000 was based on the anticipated liquidation value of those assets. The exchange ratio adopted was based upon that total evaluation of Peoria's assets and market value of ACI's stock of $17.75 per share on March 11, 1965. The exchange ratio of 5 to 1 placed an evaluation of Peoria's stock of about $3.55 per share on the basis of the March 11 value of ACI.[3] (328 F. Supp. at 803)
>
> ---
>
> [3] The market value of ACI on March 31, 1965 was $20.25. If measured by that figure, the price paid for Peoria's assets exceeds $330,000, or over $4.00 per Peoria share." (emphasis added)*

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* This Swanson footnote conclusively repudiates plaintiffs' argument that the value of Atron stock should be measured by the value of Mohawk stock on the day the agreement received stockholder approval, April 30. (See Pl. Br. 10. fn.)

In other words, Swanson stands for the proposition that, on the special facts of that case, fair cash value could be determined by reference to liquidation value.*

Had the Swanson approach been applied in this case, defendants would not be here now. The per share net asset value of Atron was substantially less than the value of the Mohawk stock plaintiffs received in exchange. Since Atron's books included sizeable intangible bookkeeping assets, its liquidation value can only have been less than its book value.

(d) Plaintiffs' New April 21 Theory

Plaintiffs also argue, for the first time on this appeal, that if their damages are not measured by Mohawk's price on April 30, they should be measured by its price on April 21 because on that date, plaintiffs imagine,

> "Mohawk could have disaffirmed the whole merger . . . but chose not to." (Pl. Br. 18)

Plaintiffs rely upon the boiler-plate provision contained in paragraph V(1)(a) of the merger agreement that:

> "All transactions contemplated hereby which are legally required to be approved by the stockholders of the Constituent Corporations shall have been approved by the respective

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* It should be noted that the Swanson court had before it data as to all the traditional components of fair cash value. Peoria stock had recently been bid at prices ranging from 4-1/2 to 5-3/8. 415 F.2d at 1331, n. 4. As to earnings value, Peoria had not had any earnings for years. 328 F. Supp. at 802. Given all this record data, and given the fact that under the Court's formula, the maximum damages involved were almost trivial (a few thousand shares, times $3.55, less the value of the ACI stock not exchanged), it would have been preposterously wasteful to have sent the case back for a third trial in order to obtain a more formal judicial appraisal of fair cash value.

> requisite statutory action of such stockholders [prior to the closing]." (A. 518)

On this basis, plaintiffs argue that since MDS-Atron (the wholly-owned Mohawk subsidiary into which Atron was actually merged) only finally gave its pro forma approval to the merger on April 21, Mohawk, as sole shareholder of MDS-Atron, had complete freedom until that day to walk away from the merger by the simple expedient of withholding MDS-Atron's approval. The language of the contract is to the contrary: Mohawk and MDS-Atron were required to give their consents. See ¶¶ III(5) and IV(3) of the merger agreement. (A.516-17) Plaintiffs' remarkable argument requires no further refutation.

2. The Value of the Exchanged Mohawk Stock

In our main brief, we demonstrated that the District Court erred on the low side in determining the value of the Mohawk stock which plaintiffs received on April 30. Some of its errors were theoretical, others were mechanical and arithmetical. The total effect was sizeable.

Plaintiffs do not pretend to defend the District Court's calculations. Addressing none of our arguments, plaintiffs refuse even to acknowledge the District Court's arithmetical mistakes. Against their own interests, plaintiffs have admitted that the value of Mohawk stock on April 30 was $28.25 ($6.75 more than the $21.50 figure which the District Court literally invented). See A. 992. However, plaintiffs deny the relevance of this admission, claiming that damages should be measured by

the difference between market value of Mohawk stock on April 30 and the price at which it was later sold; or, to the extent that their Mohawk stock was not sold, that they should now be able to recover the April 30 value of unrestricted Mohawk stock and to return the stock they have speculatively retained. Plaintiffs cite no authority for their position, save for Swanson, supra. As we have pointed out at pp. 6-8, supra, that case provides no support for plaintiffs' contentions.

Nor is there any other basis, legal or equitable, on which plaintiffs' theory may properly be sustained. They now claim that, because of arguable omissions from a proxy statement four years ago, defendants must guarantee them against any subsequent losses in the speculative investment they determined to retain. The securities laws neither require nor permit so cynical a result. Cant v. A.G. Becker & Co., Inc., 379 F. Supp. 972, 975 (N.D. Ill. 1974); see Harris v. American Inv. Co., CCH Fed. Sec. L. Rep. ¶ 95,208 (8th Cir. 1975).

B. The Issue of Materiality

As to materiality, defendants have shown that, in the context of the transaction at issue here, most of the omitted data was immaterial under any standard and the rest of the data simply did not exist prior to the April 30 shareholders' meeting; the District Court's contrary holding was based upon a misreading of the record and a misplaced reliance upon misleading passages of plaintiffs' post-trial brief. More important, defendants have

demonstrated that the District Court adopted an erroneous definition of materiality, requiring only that the omitted fact might be important to an investor, instead of determining whether

> "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question." List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965) cert. denied sub nom, List v. Lerner, 382 U.S. 811 (1965) (emphasis supplied)

1. The Proper Standard

It is simply not enough that an omission might be important to somebody. Anything is possible, especially in retrospect, and most certainly when money may be made. Neither these nor any other corporate defendants should be subject to enormous potential liabilities under Section 14(a) as a result of an inadvertent failure to state a fact which merely "might" affect some investor's judgment. Damages of this magnitude should be based on more than "maybe's." The virtually limitless expanse of litigation implicit in plaintiffs' easy standard would tempt the most scrupulous of investors toward self-serving second guessing of all investments. In contrast, the prevailing "would" standard is not only just, but also pre-eminently practical. See generally, Blue Chip Stamps v. Manor Drug Stores, 43 U.S.L.W. 4707 (June 9, 1975).

2. The Substance of the Omissions

Plaintiffs' brief appears to suggest that defendants hid some vast loss of Mohawk income from the Atran stockholders. Nothing of the sort is involved in this case. The complaint is

that defendants did not disclose in the proxy statement (1) a decision to change Mohawk's fiscal year from one ending July 30 to one ending April 30; (2) a decision to terminate a financing device, initiated only the year before, whereby certain leases were "sold" to third parties; and (3) a decision to change from one accepted accounting system to another with respect to such third-party sales.

As to the change in Mohawk's fiscal year, plaintiffs assert that whenever a company changes its closing date, one can be certain some disaster is being hidden away in books; therefore, a failure to disclose so momentous an event must be material. Naturally, plaintiffs cite no authority. There is none. Such changes are routine.

Plaintiffs refer to Mohawk's abandonment of its brief experiment with third-party sales as a "cessation of its primary financing practice." (Pl. Br. 23) However, plaintiffs choose not to mention that this "primary" practice involved only 4% of Mohawk's business, or that its abandonment had no impact upon the total number of computers being manufactured, leased or sold by Mohawk. If this be primary, one must wonder what could be secondary.

Finally, with respect to Mohawk's change from one accepted accounting system to another for its third-party sales, plaintiffs argue that if Mohawk had not made the change, it would have had 11¢ more income per share in fiscal 1971. But this

argument glides too quickly past the critical fact that, as a result of the change, the income not booked in 1971 was to be booked instead in subsequent years. Thus, the manner and timing of Mohawk's realization of income was adjusted for bookkeeping purposes, but the ultimate business reality was unaffected.* Further, the accounting change decision could not have been disclosed in the proxy statement because that decision, as shown in our main brief (pp. 49-53), was not made until after April 30.**

Plaintiffs fill their brief with a good many large numbers and confusing calculations. Most of the confusion arises from plaintiffs' intermingling the effects of the voluntary accounting change with the effect of an increase in reserves for

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* By changing the system for 1971, it was necessary for Mohawk to restate its 1970 income in order to preserve comparability. The effect of this retroactive change deferred sufficient 1970 revenues to other years to cause a bookkeeping reduction of 27¢ per share in the restated 1970 income figure.

** Plaintiffs' sole support for their claim that this decision antedated April 30 is a registration statement Mohawk filed with the SEC in August, 1971, which contained a financial statement footnote referring to the accounting change as made "during fiscal 1971" (A. 611) But this footnote simply explains that the change was retroactive for all of fiscal 1971. The footnote clearly uses "during" as meaning "with respect to." Indeed, no matter when this change was informally agreed to by Mohawk's officers, it is clear for the purposes of an SEC registration that the change was not officially made until formally approved by Mohawk's Board of Directors -- and that was not done until June 30, 1971, two months <u>after</u> the merger (A. 407). The clearly intended purport of the footnote should note be twisted into an untrue and unintended meaning.

fiscal 1971 of almost $3,000,000, which Mohawk and its auditors first realized was necessary in the course of completing Mohawk's annual audit in June, 1971 -- long after the merger. For all of plaintiffs' convoluted arithmetic, the bottom line is clear: the 1971 effect of Mohawk's voluntary change in its system of accounting for the 4% segment of its business relating to third-party sales resulted in nothing more than a deferral to other years of 11¢ in income per Mohawk share.

3. <u>The Context of the Transaction</u>

Finally, the immateriality of the alleged omissions must be appreciated in the context of the desperate situation confronting Atron on April 30, 1971. Merger with Mohawk was virtually Atron's sole hope of survival, and the Atron stockholders' sole hope of salvaging their endangered investment. In this context, whether or not Mohawk disclosed such insignificant items as changes in its fiscal year or in its method of accounting for third-party sales was simply of no moment.

Plaintiffs dispute the assertion in defendants' main brief that Atron was suffering monthly operating losses of $200,000 in 1971. We note that the District Court also read the record as showing such a loss. (A. 939; 387 F. Supp. at 1323) But even assuming that plaintiffs' version of the slightly ambiguous record is correct, it would mean only that Atron's operating losses were $200,000 a quarter.* What is critical, and completely beyond

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* Because of its substantial interest income from its cash holdings, Atron's net loss was somewhat less.

question, is the fact that Atron suffered these continuing operating deficits right up to the moment of merger (A. 915; 387 F. Supp. at 1315). And the fact that Atron was about to lose its virtual sole customer -- Mohawk -- would surely have supplied the coup de grace.

Plaintiffs attempt to downplay Atron's desperate situation by painting a remarkably rosy picture of Atron, past and prospective. We trust that were plaintiffs preparing a proxy statement, instead of a brief, they would be somewhat more circumspect. A more realistic depiction of the situation was given to plaintiff LeLandais by Joseph F. Stoutenburgh, then president of Atron, on February 17, 1971. Stoutenburgh, at trial, described that conversation in detail (A. 311-12):

> "The Court: Just tell us what you said in substance and what he said.
>
> "The Witness: He said in substance that it was absolutely essential that Atron find a long-term solution to what appeared to be a most dangerous business posture. I amplified that in detail.
>
> With regard to the lack of success, in particular with regard to the outright sale to other equipment manufacturers, called O.E.M. sales, because that provides cash, that the Mohawk commitments had been met by Mohawk and that they had the right to manufacture, and that in our opinion they had to consider that seriously. That represented 90 percent of our current sales.
>
> The posture of entering the end user market, which we were trying to do, established a cash need that looked extremely difficult to achieve. The equity market was poor and the bank credit line was poor and the cost of selling to an end user, where you manufacture, have to place it in inventory and you have to finance the sales, the spare parts

distribution and the service of that; and you receive your money and only recover your cost at best over about a two year period, a period to be very discouraging in the long run.

We had looked at other possible acquisitions to improve that long-run picture, without success, and that this opportunity for a merger with Mohawk, with the companies matching as well as they did in both personnel and product, [appeared] to be in the best interest of the stockholders.

"Q. Did Mr. LeLandais say anything to you on that occasion?

"A. On those principles it is my recollection that Mr. LeLandais did not disagree."

In this context, no reasonable Atron shareholder would have cared very much whether Mohawk used the "operating" or the "financing" method of accounting for third-party sales, or whether Mohawk's 1971 income was up or down 11¢. The omissions were not material.

C. Reliance

The legal issue here is clear, and has not yet been resolved by this Court. Assuming that once a material omission in the proxy statement has been proved, plaintiffs' reliance can be presumed, defendants insist that this presumption is rebuttable and that they did rebut it below. The District Court's refusal to consider defendants' evidence on this point, in the mistaken belief that the presumption is irrebuttable, requires reversal of the judgment entered below.

Plaintiffs rely on two Supreme Court class actions, Mills v. Electric Auto Light, 396 U.S. 375, 385 (1970) and Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972), to support the District Court's refusal to consider

the relevant evidence. But this Court has explicitly recognized that these decisions leave open the question whether reliance is to be conclusively presumed from proof of a material omission under § 14(a). Lowenschuss v. Kane, CCH Fed. Sec. L. Rep. ¶ 95,104 at 97,925, n. 11 (2d Cir. 1975).

To hold the presumption of reliance irrebuttable would produce patently unjust results never contemplated by Congress when it enacted the Act. It would permit recovery by a plaintiff even if he openly acknowledged that the material facts omitted from a proxy statement were known to him at the time and were of no importance to him whatsoever. Recovery is plainly not appropriate in such a situation, because there is no causal connection between the omission complained of and any loss the plaintiff may have suffered on his investment; any injury flows from plaintiffs' own poor judgment, not from any act or omission of the defendants.

In this case, several sophisticated plaintiffs were trapped in restricted investments in a rapidly failing company. So eager were these plaintiffs to find a way out of that investment, it would not have given them a moment's pause had they received earlier information that Mohawk had changed its fiscal year from July 30 to April 30, or that it might change from one to another legitimate method of accounting for third-party sales. The District Court should have considered the defendants' evidence on this point and weighed it against the presumption of reliance; its refusal to do so was clear error.

POINT II

THE DISTRICT COURT PROPERLY DISMISSED THE CLAIMS OF PLAINTIFF ITNR (ANSWERING POINT IV OF PLAINTIFFS' BRIEF)

The District Court dismissed the claims of one of the six plaintiffs herein, ITNR. That plaintiff now argues that such dismissal was based solely upon the fact that ITNR failed to vote one way or another on the merger proposal. But ITNR's failure to vote was not the sole predicate of the District Court's judgment, nor the critical defect in the ITNR claim. As it implicitly acknowledges, ITNR not only did not vote, it never even saw, much less relied upon, the proxy material in question. (Pl. Br. 34-35) Therefore, ITNR did not rely upon and could not have been deceived by anything which might have been misstated in or omitted from that material.

It is critical to remember that, by plaintiffs' own careful design, this action is not a class or derivative action. It is, instead, a complaint by six individual, sophisticated investors that they were each individually misled or damaged by the proxy statement. There is no allegation in this complaint that any Atron shareholder other than these six plaintiffs was deceived by anything. There is no claim in the amended complaint that this merger would have been rejected but for the allegedly inadequate proxy statement. It is not even suggested that this merger might have been rejected but for such statement and, indeed, the intimations of the District Court are quite to the contrary. (A. 958; 387 F. Supp. at 1330) This case was commenced -- and tried -- on the theory that these plaintiffs were injured because <u>they</u> relied upon the proxy statements and would have acted differently had <u>they</u> known the data they now say should have

been set forth therein. It is too late for ITNR to expand the scope of its complaint.

Having eschewed the burdens associated with bringing a class action, plaintiff ITNR cannot now enjoy the benefits of such an action. Nor can it claim that § 14(a) is a blanket insurance policy against all related loss. (Robbins v. Banner Industries, Inc., 285 F. Supp. 758, 762 (S.D.N.Y. 1966))

Instead, ITNR could recover only if it could prove its claim that it was misled by the proxy statement and, thus, lost its rights to an appraisal of the fair cash value of its Atron stock. ITNR did not (and cannot) discharge this burden.

ITNR apparently purchased 5,000 shares of restricted Atron stock in September 1969 at a private placement. The certificates were originally issued to plaintiff RSI, and were "sold" to ITNR in November 1969. In December of that year, at RSI's request, record ownership of this stock was placed in the name of Boyd & Co. (A. 917; 387 F. Supp. at 1316) As the District Court found:

> "All that ITNR acquired [in 1969], or held at any relevant time, was equitable ownership." (Id.)

At the time of the merger, Atron mailed the proxy materials relating to ITNR's stock to the record holder. As stated by the District Court,

> "In 1971, a corporation such as Atron was not required to concern itself with whether nominees acting for offshore equitable owners of stock discharged their duties adequately, or communicated properly or sufficiently with their principals. When the owner of stock elected not to become the holder of record, but to place legal title in a nominee or custodian, . . . he accepted the risks consequent thereon." (A. 919; 387 F. Supp. at 1317)

It appears that ITNR's agents failed to transmit this material to ITNR in time. There is no evidence in the record that ITNR ever saw the proxy material prior to the merger vote on April 30, 1971. (No one from ITNR testified at trial.)* The District Court was clearly correct in finding that "ITNR at a critical point, 'failed to get the word' from Atron or Mohawk . . . ." (A. 919; 387 F. Supp. at 1317) and that if ITNR were damaged at all, it was damaged as a result of such failure "to get the word" and not by any act of defendants.**

ITNR may have a claim in negligence against its agents for their failure to transmit this material; but -- as the Court below recognized -- it cannot recover from these defendants on the theory that _it_ was deceived or misled by a document which it never saw.

ITNR cites three cases in support of its efforts to fasten upon defendants' damages for the injuries caused by its agents. In none of these three cases, _Swanson_, _supra_, _Schlick_ v. _Penn Dixie Cement Corp._, 507 F.2d 374 (2d Cir. 1974), _cert_. _denied_, 43 U.S.L.W. 3614 (May 20, 1975) or _Mills_, _supra_, did the plaintiff simply sit back, doing nothing, whether out of indolence, ignorance or strategy. Rather, each of those plaintiffs took active steps to prevent a merger or correct the consequence of a merger he thought unwise.

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* It is stated at page 3 of plaintiffs' Brief that, "all of the plaintiffs received and read the proxy statement prior to submitting their proxies," but the cited portions of the record contain no evidence of this claim as it pertains to ITNR, and it is admitted that ITNR did not, in fact, "submit" its proxy. Elsewhere, plaintiff ITNR does admit that its "failure to vote . . . was an administrative failure of communication," and that "the physical handling of the proxy went awry." (Pl. Br. 34-35)

** Similarly faulty communications were apparently responsible for ITNR's subsequent failure to make a timely request for the registration of the restricted Mohawk stock it received as a result of the merger. (_See_ p. 30, _infra_.)

But more important, each of those plaintiffs acted on behalf of a class, and each claimed an injury to the class, not just a private injury to himself.

In this action, unlike the class action situation, there is no need to formulate any presumption of reliance to overcome what might otherwise be a virtually insurmountable burden of proof for the plaintiff. (Cf. Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 373-75 (2d Cir. 1973). Since it claimed that it was individually injured by the proxy, it was only proper that ITNR be put to its proof. It failed to prove that it even saw the proxy statement.

Where a single shareholder -- such as ITNR -- seeks to recover under § 14(a) in a non-class, non-derivative action, that shareholder must demonstrate, as an essential element of its claim, that it relied on the allegedly misleading proxy -- in short that it suffered "transaction causation," in the sense that "the violations in question caused the [shareholder] to engage in the transaction in question." Schlick, supra, 507 F.2d at 380. And that simply is something ITNR did not do in the Court below -- and, on the admitted facts, never could do.

The District Court was, therefore, correct in dismissing ITNR's claim.

POINT III

THE DISTRICT COURT CORRECTLY DISMISSED PLAINTIFFS' CLAIMS THAT THERE WAS ANY SORT OF DECEPTION RELATING TO "FREE STOCK" (ANSWERING POINT V OF PLAINTIFFS' BRIEF)

Finally, plaintiffs endeavor, on their cross-appeal, to reverse the dismissal below of all their different theories of a so-called "free stock deception." These theories arise from the fact that all holders of restricted Atron stock received similarly restricted Mohawk stock in exchange upon the merger. In their fifth point, plaintiffs complain that,

> "The District Court dismissed the portion of plaintiffs' complaint which was based upon this 'free stock' deception. The opinion below is not clear as to the reason for dismissal. It says simply that there is a 'complete failure of proof,' . . ." (Pl. Br. 37)

We would have thought that "a complete failure of proof" was not only a clear but even a compelling reason for dismissal.

This "free stock" question was the heart of the case below. The amended complaint alleged (1) that plaintiffs had received oral representations from Atron's president Stoutenburgh that they would receive free Mohawk stock on the merger (Counts 1 through 4; A. 40-44); (2) that the proxy statement falsely suggested that they would receive free stock (Counts 6 through 8; A. 45-48); and (3) that the proxy statement wrongly omitted to state that Mohawk could not legally issue unrestricted Mohawk stock in exchange for restricted Atron stock absent a new registration under the 1933 Act (Count 5; A. 44-45).

The District Court rejected each and every one of plaintiffs' variations of this theory.

With respect to claims that these were oral misrepresentations, the Court below simply found that no such representations were ever made and the plaintiffs' testimony to the contrary was "incredible." (A. 933; 387 F. Supp. at 1321)

With respect to the claim that plaintiffs were affirmatively misled by the proxy statement, the Court fully concurred with defendants' conclusion that, as a matter of law, Mohawk was prohibited from simply exch[illegible]ing unrestricted Mohawk stock for restricted Atron stock and found that plaintiffs knew or should have known as much. Plaintiffs have never challenged this legal principle.

Finally, with respect to plaintiffs' claim that the proxy statement wrongly omitted to state the indisputable legal fact that Mohawk would not and could not issue "free" stock in exchange for restricted stock, the District Court expressly found that the proxy statement did <u>not</u>

> "[omit] to state material facts necessary in order to make the statements therein not misleading, with respect to the question of whether restricted shareholders of Atron would receive unrestricted shares of Mohawk in the merger which could be sold in market transactions without registration under the Securities Act of 1933." (A. 942; 387 F. Supp. at 1324)

A. <u>Plaintiffs Knew They Would Receive Restricted Mohawk Stock</u>

Plaintiffs acknowledge that the dismissal below of their claims of affirmative oral and written misrepresentations in this regard was supported by adequate evidence. They purport to cross-appeal only from the dismissal of their third variation upon their theme -- the "omission" claim. This acknowledgement, however, does not restrain them from an improper surreptitious attempt to resuscitate the rejected claims.

Thus, as to the dismissed claim of affirmative oral

misrepresentation, plaintiffs stoop to what is an architypal model of a truly material omission, by informing this Court that

> "Mr. LeLandais, in a conversation with Atron's president [Stoutenburgh], was led to believe that holders of restricted Atron stock would receive unrestricted Mohawk stock" (Pl. Br. 36)

without mentioning the trial court's finding that

> "Plaintiffs have not proved to my satisfaction that the conversation with Stoutenburgh took place as claimed. There is no corroboration for the conversation and competent credible evidence exists directly to the contrary." (A. 933; 387 F. Supp. 1321)

Plaintiffs similarly attempt to revivify their theory that the proxy statement was affirmatively misleading. They coyly suggest that they were confused by a passage in the statement that prior to the actual merger, Mohawk would insist on receiving commitments from certain Atron shareholders with respect to the disposition of the Mohawk stock they were to receive. (Pl. Br. 41)* Plaintiffs did not make this particular argument below, and so, of course, should not raise it now. (See, e.g., Hormel v. Helvering, 312 U.S. 552, 556 (1941); United States v. Vitasafe Corporation, 352 F.2d 62 (2d Cir. 1965).) However, the District Court was in fact well aware of this particular proxy provision (A. 941; 387 F. Supp. at 1324) and nonetheless found that the proxy statement was not affirmatively misleading. **

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* In this connection, plaintiffs misstate the portion of the record they purport to summarize. (See, A. 554, last sentence.)

** Since this point was not raised below, the record is incomplete, but, as this Court can readily surmise, such letters from Atron promoters and insiders were required for wholly unrelated reasons, involving the operation of Rule 133. We attach a copy of the relevant document as an appendix to this brief in order to suggest what we would have proved had this point been made below.

Plaintiffs' back-door attempts to reargue their rejected claims of affirmative misrepresentation are improper, should be disregarded, and, in any event, are without merit.

The one ground on which plaintiffs do cross-appeal -- the omission claim -- is also without merit.

The crux of the District Court's conclusion was that the specific plaintiffs here were not deceived by anything within or without the proxy statement relating to restricted stock. Each and every one of these six plaintiffs was a sophisticated investor. (A. 912, 917; 387 F. Supp. at 1314, 15) Indeed,

> "Plaintiffs each had substantial experience in dealing with restricted stock purchased from other issuers." (A. 927; 387 F. Supp. at 1319)

When these plaintiffs acquired their restricted Atron stock, they agreed to be bound by standard restrictions on resale. As the trial court found,

> "plaintiffs had actual knowledge of the terms and conditions of their respective subscription agreements and the letters given in usual form, representing their investment intent. These plaintiffs specifically agreed with Atron that the shares to be received by them were to be restricted as to transferability and that the certificates representing these shares would carry a restrictive legend. Each purchaser represented that he or it was purchasing the Atron shares for investment purposes only, and not with a view to distribution, and agreed that the shares would not be sold unless registered with the Securities and Exchange Commission, or following receipt of an opinion from Atron's counsel that the shares could be sold without registration. (A. 916; 387 F. Supp. at 1315)
>
> * * *
>
> The restrictions and representations contained in the investment letters are self-executing, wholly without regard to whether the certificates bear a restrictive legend. The restrictive agreements or investment letters were clear, and their traditional meaning well known to plaintiffs. The Atron stock had been held by plaintiffs for relatively short

> periods. . . . It was generally known in 1971 by such investors that a merger was foreseeable when the state of mind represented to exist in their investment letters came into being, and that the mere occurrence of a subsequent merger is not one of the accepted changes of circumstances upon which counsel may found an opinion relieving parties to an investment letter therefrom and approving sale without registration." (A. 926-27; 387 F. Supp. at 1319)

There is no more authoritative statement concerning what the S.E.C. would and would not allow on this score than the well known Report of S.E.C. Commissioner Wheat and his staff. It is unequivocal:

> "Assume, for example, that an investor purchases in a nonpublic offering shares of a company which later merges into another company. Even if the specific merger was not in contemplation at the time of the original investment, the Commission's staff has taken the position that a merger is an event reasonably to be anticipated in the life of a company, and hence does not constitute a sufficient 'change of circumstances' [to warrant a "No Action" letter]. The stock of the surviving company received as a result of the merger is therefore held subject to the same restrictions as the stock originally purchased in the private offering." (The Wheat Report, Disclosure to Investors, 1969, at pp. 166-67)

Since these sophisticated investors knew that their restricted investment in Atron would not be rendered unrestricted as a result of the merger, these plaintiffs, as a matter of law, knew (or should have known] that they would receive restricted Mohawk stock. This knowledge was immaterial to them as a matter of fact, since it obviously did not dissuade them from their support of the merger. Therefore, whether plaintiffs phrase their attack in terms of an omission or otherwise, the District Court was nonetheless absolutely correct in its conclusion that

> "if any of these plaintiffs drew the inference therefrom which they say they did, it was entirely

> unwarranted, and may not be a basis for fastening liability on defendants." (A. 930; 387 F. Supp. at 1320)

In essence, plaintiffs seek to recover enormous damages because the proxy statement failed to state that Mohawk would not perform an illegal act: issuing unrestricted stock without a registration statement.

Since they were not "deceived" by this "omission," plaintiffs must lamely suggest that perhaps some other stockholders were. However, this is not a class action or a derivative action, and even if it were, these plaintiffs would lack standing to pursue such a claim. They cannot be heard to claim damages because someone else might have been confused by the nondisclosure of a datum which these plaintiffs knew about as a matter of law and were indifferent to as a matter of fact. _See_, _e.g._, _Simon_ v. _Merrill Lynch, Pierce, Fenner and Smith, Inc._, 482 F.2d 880, 884 (5th Cir. 1973); _Nanfito_ v. _Tekseed Hybrid Co._, 473 F.2d 537, 541-42 (8th Cir. 1973); _City National Bank of Fort Smith, Ark._ v. _Vanderboom_, 422 F.2d 221, 229-31 (8th Cir. 1970), _cert._ _denied_, 399 U.S. 905 (1970); _Kohler_ v. _Kohler Co._, 319 F.2d 634, 641-42 (7th Cir. 1963), which establish that the investor has a duty to exercise due diligence, notwithstanding the duty under the securities laws to disclose.

B. In Context, the "Omission" Is Not Material

Further, the whole matter is immaterial by any standard -- "would," "might" or "wildest dream." On January 29, 1971 when the principals of Mohawk and Atron agreed to the merger in principle, Stoutenburgh asked whether holders of restricted Atron stock would receive freely transferable

stock as a result of the merger. Mohawk's spokesmen indicated they believed that there were technical S.E.C. problems involved and, so, that they would need to consult their lawyers (A. 422-23), but that they would issue free stock if they could. (A. 940; 387 F. Supp. at 1323) Mohawk went on to indicate that in any event, Atron shareholders would be afforded an opportunity to register their new Mohawk stock at the next regular (usually annual) registration of Mohawk stock. (A. 423)

As any securities lawyer or sophisticated investor would have known, unrestricted Mohawk stock could not have been issued to these plaintiffs without a registration under the 1933 Act. The possibility of such a pre-merger registration was not even raised at the January 29 meeting. (A. 941; 387 F. Supp. at 1323)

Subsequent to the merger, when Mohawk mailed the former Atron shareholders their new Mohawk stock, it enclosed a letter explaining that while the Mohawk shares were necessarily restricted it would undertake to register the Mohawk stock of those shareholders who so desired. The letter additionally outlined some of the consequences of registration and non-registration. (A. 601-03) Many of the new Mohawk shareholders did request registration, and their stock became registered and freely transferable effective August 25, 1971.* Despite their feigned or ostensible surprise at receiving restricted stock, the plaintiffs wanted a full year to buy their complaint, nine months after their stock was registered.

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* Plaintiff ITNR failed to make a timely request for registration and its stock was not registered, which is one indication of just how material this whole matter is.

Obviously, it was, at most, a secondary concern to the Atron shareholders, seeking some escape from their illiquid investment in a failing company, whether the Mohawk stock they were to receive was registered prior to the merger or shortly thereafter.

C. Plaintiffs' Miscellaneous Arguments Are Wrong and Irrelevant

In a final effort to salvage their claim, plaintiffs have invented a miscellany of extraordinary arguments.

Thus, plaintiffs suggest that the alleged omission from the proxy statement was "significant" because Mohawk, the largest single holder of restricted Atron stock, could issue unrestricted Mohawk stock to itself in the merger exchange. (Pl. Br. 40) This argument is made on the face of contrary provisions of the proxy statement and of the securities laws. The fact is that the shares of Atron owned by Mohawk were cancelled in connection with the merger and no shares of Mohawk's common stock were issued to Mohawk in exchange for its Atron shares.* (A. 553)

Plaintiffs also argue that if the proxy statement had expressly stated that restricted stock would be issued, "Every holder of Atron restricted stock . . . . would have dissented, demanded appraisal, and received cash." (Pl. Br. 42-43) To the contrary, had every such holder done so, they would not have received cash; rather, the merger proposal would have been rejected and they would have been stuck with their restricted investments in a failing company on the edge of final collapse. Indeed, one can safely conclude that no

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* Even were this argument not false in its facts and on its face, its meaning would elude us.

rational stockholder would have done so, realizing instead that after the painfully slow and potentially expensive process of appraisal, he would very likely receive a fair cash value far less than the value of of the restricted Mohawk stock offered in exchange on April 30.

Plaintiffs also seek to make something from the claim that, on the day of the merger, Mr. Stoutenburgh believed that registered stock would be issued.* But even if Stoutenburgh were confused whether the new Mohawk stock would be freely transferable before the merger or shortly thereafter, it is no help to plaintiffs, since they were not confused. Unlike plaintiffs, Stoutenburgh was not found to be a sophisticated investor. Mr. Stoutenburgh is not a lawyer. He is a scientist.

Plaintiffs also suggest (for the first time and in a footnote) that the S.E.C. is of the view that, "non-disclosure regarding transfer restrictions is a deceptive practice." (Pl. Br. 38) Plaintiffs omit to state that the S.E.C. release on which they belatedly rely purports to deal only with the private offering and issuance of new restricted securities, not, as here, with the exchange of restricted securities for restricted securities. Nor do plaintiffs anywhere state that this S.E.C. release was issued on January 10, 1972, nine months <u>after</u> the merger. The footnote argument on this S.E.C. release is too late, out of date and off-point.

Plaintiffs go on to find some unidentified meaning in

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* Stoutenburgh's actual testimony was considerably more tentative. Stoutenburgh knew that he and other "promoters" would not receive free stock. As to the other restricted Atron shareholders, "there was no reason for me at that point to believe that they would not" receive registered stock. (A. 309)

the fact that the boiler-plate text of the restrictive legend on the original Atron stock employed different words than did the legend on the subsequent Mohawk stock. The Atron legend took at least two different forms, reading:

> "The purchase of common stock represented hereby have not been registered under the Securities Act of 1933, as amended and may not be sold or transferred, or transferred on the books of the company maintained for such purpose, until registration under said act shall have been effected or in the opinion of counsel satisfactory to the company registration under said act is not required in connection with such proposed sale or transfer." (A. 78)

or,

> "The shares represented by this certificate have been purchased under investment presentations and no transfer or other disposition may be made except in compliance with the requirements of the Securities Act of 1933." (A. 50)

The Mohawk legend was slightly briefer than the longer Atron version:

> "The shares represented hereby are not registered under the Securities Act of 1933, as amended, and may not be sold, transferred or otherwise disposed of except in compliance with such act and upon an opinion of corporation's counsel to that effect." (A. 79)

We submit that these texts, while slightly different in language, serve quite the same function.

Plaintiffs' most strained suggestion is their argument that even though Mohawk could not issue free stock without a registration under the 1933 Act, the proxy statement should have expressly disclosed that Mohawk would not initiate and complete a registration of this new stock prior to April 30, 1971. Plaintiffs seriously seem to suggest that they should receive hundreds of thousands of dollars in damages because the proxy statement did not expressly state that Mohawk would not do something which Mohawk was under no duty to do, which Mohawk had never intimated it might do, and which plaintiffs had

no reason to believe Mohawk would do: complete a registration before the merger date. If plaintiffs had any honest hope, however unfounded, that Mohawk might voluntarily have assumed the onerous and expensive task of rushing through a registration to be effective before the merger, it would have been sensible for them to have asked. They did not. Defendants are not required to anticipate the need to negate all the non-facts which plaintiffs might be able to imagine. The Court below so found.

CONCLUSION

For the reasons set forth herein and in their main brief, defendants respectfully submit that the judgment below should be reversed and the amended complaint dismissed, or, at a minimum, the case should be remanded for the purposes set forth in defendants' main brief. Further, defendants submit that so much of the judgment below as is appealed from on the instant cross-appeal should be affirmed.

Dated: New York, New York
July 31, 1975

Respectfully submitted,

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Martin Kleinbard
Robert L. Laufer
Neal Johnston

Of Counsel

APPENDIX

April 30, 1971

MOHAWK DATA SCIENCES CORP.
Palisade Street
Herkimer, New York 13350

Gentlemen:

In order to induce you to consummate the transactions contemplated by the Agreement and Plan of Merger, dated as of March 12, 1971 (the "Agreement"), among MDS-Atron, Inc., Atron Corporation ("Atron") and you, each of the undersigned, owning the number of Common Shares of Atron set forth opposite his and/or her name at the foot hereof, does hereby covenant and agree with you that:

1. The shares of your Common Stock to be received by the undersigned in connection with the transactions contemplated by the Agreement will not be sold, distributed or otherwise disposed of in violation of the Securities Act of 1933, as amended (the "Act"), and the rules and regulations thereunder, with the understanding that such shares may be disposed of in accordance with the provisions of paragraphs (d) and (e) of Rule 133 under the Act; and

2. Certificates representing the above-mentioned shares of your Common Stock may bear a legend to the effect that such shares are subject to the above-described undertaking, and appropriate stop transfer orders may be lodged with the transfer agent for your Common Stock; provided, that after the consummation of the merger, you shall instruct your transfer agent to issue certificates which do not contain such a legend and remove such stop transfer orders (i) in connection with any disposition of such shares in accordance with the provisions of paragraphs (d) and (e) of Rule 133 under the Act, provided you shall have received representations satisfactory to your counsel that such provisions have been or will be complied with in connection with such disposition, (ii) on and after such date as restrictions upon the sale, distribution or other disposition of such shares represented thereby, either in the opinion of your counsel or pursuant to a "no-action" letter which may be issued by the Securities and Exchange Commission with respect thereto, are no longer required under the Act, or (iii) in connection with any transaction in which any such

shares are sold, distributed or otherwise disposed of pursuant to and in accordance with a registration statement which has become and is effective under the Act (but you shall not be obligated to file any such registration statement).

Very truly yours,

ber of n Common es Owned	
,000	Robert J. Gountanis and Eva Nancy Gountanis, as joint tenants
2,000	Robert J. Gountanis, individually
0,000	Mark M. Koschmann and Dorothy L. Koschmann, as joint tenants
7,000	Finley E. McLeod, individually
72	Ruth E. McLeod, as custodian for minor children
2,000	Herman Osofsky and Audrey J. Osofsky, as joint tenants
0,000	Dennis C. Stanga and Marlene B. Stanga, as joint tenants
,000	Joseph S. Stoutenburgh, individually

pted and confirmed as of the
first above written:

K DATA SCIENCES CORP.

ice President

SCHWENKE & DEVINE
RECEIVED 7/31/75 @ 4:00 pm
E Mkaius
Rec'd 3 copies